

**MINUTES
of the
SECOND MEETING
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE**

**July 28, 2014
Room 307, State Capitol
Santa Fe, New Mexico**

The second meeting of the Investments and Pensions Oversight Committee (IPOC) for the 2014 interim was called to order by Representative Jim R. Trujillo, chair, on Monday, July 28, 2014, at 10:15 a.m. in Room 307 of the State Capitol in Santa Fe.

Present

Rep. Jim R. Trujillo, Chair
Sen. George K. Munoz, Vice Chair
Rep. Larry A. Larrañaga
Sen. Carroll H. Leavell
Sen. Bill B. O'Neill
Rep. Jane E. Powdrell-Culbert
Rep. William "Bill" R. Rehm
Rep. Luciano "Lucky" Varela

Absent

Sen. Sue Wilson Beffort
Sen. Jacob R. Candelaria
Sen. Steven P. Neville
Rep. Henry Kiki Saavedra
Sen. William P. Soules

Advisory Members

Rep. Donald E. Bratton
Sen. Carlos R. Cisneros
Rep. Miguel P. Garcia
Rep. Roberto "Bobby" J. Gonzales
Sen. Stuart Ingle
Rep. Patricia A. Lundstrom
Sen. Mary Kay Papen
Sen. John C. Ryan

Rep. William "Bill" J. Gray
Rep. Emily Kane
Sen. Timothy M. Keller
Rep. Tim D. Lewis
Sen. William H. Payne
Sen. Michael S. Sanchez
Rep. Sheryl Williams Stapleton

Staff

Lisa Sullivan, Staff Attorney, Legislative Council Service (LCS)
Celia Ludi, Staff Attorney, LCS
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
John Mitchell, Law Student Intern, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

Monday, July 28

Education Trust Board (ETB): Management of College Savings Plans Nationally and in the State; Update on Investment Performance; Time Line for Program Manager Selection

Dr. José Z. Garcia, chair, ETB, explained that the ETB is the governing body for New Mexico's 529 college savings programs, is responsible for making rules and regulations for the development and implementation of the Education Trust Act and has approximately \$2.3 billion in 156,062 separate accounts under management in two distinct investment funds. The ETB does not receive any general funds and is funded entirely by fee revenues. It is administratively attached to the Higher Education Department (HED).

Dr. Garcia introduced Kevin Deiters, executive director, ETB, who explained that a 529 plan is an education savings plan operated by a state or educational institution to help families set aside funds for future college costs. The 529 plan allows any interested person to establish an account to save money for the expected college expenses of any beneficiary. The person who establishes the account is the account owner and is the only person who can withdraw money from the account.

Mr. Deiters stated that 529 plans offer both federal and state tax benefits to the account owner and to the beneficiary. Earnings and qualified distributions on 529 accounts are not taxed to either the account owner or the beneficiary at either the federal or state level. In addition, contributions by the account owner may be deducted from net income for New Mexico individual income tax purposes. A non-New Mexico resident may not deduct contributions to the New Mexico 529 plan from other state taxes unless the applicable state specifically allows the deduction. Mr. Deiters said he would research the question of whether only the account owner is eligible to deduct the contributions from net income tax in New Mexico even though anyone may contribute to an account.

Upon a question from a committee member, Mr. Deiters clarified that qualified higher education expenses include tuition and fees at any New Mexico or out-of-state eligible institution, room and board, books and supplies, including computers.

Mr. Deiters summarized the amendments made to New Mexico's college savings programs by House Bill 215, which became effective after the 2014 legislative session.

Mr. Deiters stated that national college savings plan assets grew to approximately \$230 billion in 2013. In New Mexico, college savings assets increased to approximately \$2.3 billion in 2013. He added that growth is flattening because many beneficiaries are reaching college age and accounts are being depleted for college expenses. Eighty-five percent of account owners are non-New Mexico residents.

Mr. Deiters described the two types of ETB-administered 529 plans. The first type is the Scholar's Edge plan, which is "advisor-sold". An "advisor-sold plan" is sold to account owners by investment advisors who are paid a fee by the account owner. The second type is The Education Plan, a "direct-sold plan" that the account owner may purchase without the assistance of an investment advisor. The Scholar's Edge plan has 125,650 accounts, with a total value of \$1.84 billion.

Mr. Deiters described administrative fees charged by the ETB to account owners. Administrative fees for the Scholar's Edge plan are higher than for The Education Plan because there are more investment options in the Scholar's Edge plan.

Mr. Deiters stated that the ETB issued a request for proposals for a fund manager on May 6, 2014. The fund manager would manage both the Scholar's Edge and The Education Plan. The ETB combined the plans for management purposes to make the corpus large enough to appeal to fund managers. Both funds are currently managed by Oppenheimer Funds, Inc. (Oppenheimer). Proposals were due on July 2, 2014. A list and analysis of the proposals will be provided to the ETB and the committee on August 20, 2014. The ETB will hear presentations from the proposers on October 15, 2014 and will vote on the proposals on December 10, 2014. The new contract will begin on July 1, 2015, allowing for a six-month transition period if a manager other than Oppenheimer is selected.

In response to questions from members, Mr. Deiters informed the IPOC that litigation initiated by various plaintiffs against Oppenheimer resulting from losses to the 529 funds because of inappropriate investment decisions by Oppenheimer has been resolved. There were four actions: a class action against Oppenheimer undertaken by the New Mexico attorney general with attorneys general from several other states and three suits against the ETB. The New Mexico attorney general's suit was settled in 2010, resulting in recovery of \$67 million to be distributed to account owners of New Mexico funds. That recovery represents approximately 60 percent of losses incurred by the account owners. Three separate lawsuits were filed by private account owners against the ETB. Two of those lawsuits have been dismissed. The third, a class action, *Ping Lu et al. v. ETB*, was settled in September 2013; the settlement was finalized in March 2014. The settlement provided for payment of \$3.57 million to the plaintiffs by the ETB, with indemnification rights, if any, of the ETB by Oppenheimer assigned to the plaintiffs. In response to questions from committee members, Mr. Deiters said he would provide more specific information about the indemnification conditions. David Mathews, general counsel for the HED, said that the state has no liability under the contract with Oppenheimer but that the ETB may have liability for "gross negligence". The funds are not insured by any federal or state agencies, but they are regulated by the Internal Revenue Service, the Municipal Securities Rulemaking Board and the Securities and Exchange Commission.

Mr. Deiters introduced Kay Ceserani, principal and chief compliance officer, Pension Consulting Alliance (PCA), which has been the ETB's investment consultant since December 2011, to provide an update on investment performance. Ms. Ceserani explained that PCA is

strategically allied with AKF Consulting Group, and together they develop and implement a monitoring and guideline process for the ETB. PCA itself does not manage the investment of the funds. Prior to contracting with the ETB in 2011, PCA did not provide consulting services to any 529 programs run by Oppenheimer. PCA provides the ETB with monthly and quarterly investment performance reports and an annual assessment of Oppenheimer's annual program review. In addition, the ETB and PCA conduct site visits with Oppenheimer for review of risk management.

According to Mr. Deiters, most participants in each plan tend to select an age-based portfolio option that uses a "glide path structure", typically 20 years to 22 years in length, adjusting the asset allocation over time away from volatile equities and toward more stable fixed-income and short-term bond classes as the beneficiary comes closer to college age. The three-year risk-adjusted results show that both funds have better risk-adjusted results and achieve a higher return per unit of risk than the median of their peers. The New Mexico plans rank in the top three of the eight states' 529 plans for which PCA provides consulting services, according to Mr. Deiters.

Mr. Deiters said that PCA is paid from a combination of fees generated from the investment of the funds, fees from the program manager and fees from the ETB.

Mr. Deiters indicated that the ETB has approved \$750,000 for scholarships that may be applied to tuition, fees, supplies and books for new and continuing students who have graduated from a New Mexico high school with a minimum 3.0 grade point average (GPA) and who demonstrate that their families are unable to pay \$1,000 toward college expenses. The scholarship funds are allocated to New Mexico educational institutions, which then award the scholarships to applicants who meet the criteria. Historically, 76 percent of scholarship funds have been allocated to the University of New Mexico and New Mexico State University, but for fiscal year (FY) 2015, scholarship funds were allocated among all institutions based upon student need and GPA. This resulted in a shift of funding away from the research institutions to the comprehensive universities and two-year colleges; the research institutions were allocated 33 percent of scholarship funds in FY 2015. The scholarships are primarily funded from fees paid by Oppenheimer to the ETB. In response to a request from committee members, Mr. Deiters indicated that the ETB would provide the committee with a diversity and ethnicity breakdown of scholarship recipients and with more specific information about the sources, amounts and disbursement of funds for scholarships.

Mr. Deiters stated that the ETB has approved \$450,000 for a marketing campaign for television, radio and print to encourage more parents and others to open 529 college savings accounts. Mr. Deiters added that the ETB aims to promote discussion of college preparation and financial preparation to attend college in financial literacy courses, preferably starting in the fifth grade. Committee members suggested that the ETB collaborate with the Public Education Department toward that goal.

Minutes

The minutes from the June 17, 2014 meeting of the IPOC were approved without amendment, upon a motion duly made and seconded.

Feasibility of Implementing a State-Guaranteed Student Loan Program

Michael J. Nemelka, president, New Mexico Student Loans (NMSL), explained that NMSL is a 501(c)(3) organization composed of the New Mexico Educational Assistance Foundation and New Mexico Student Loan Guarantee Corporation, which were statutorily established in 1982 to "promote the public welfare and prosperity of the people of New Mexico [and] stimulate the availability of financial assistance for post-secondary education". NMSL is the designated Federal Family Education Loan Program administrator for New Mexico. It issues nontaxable student loan revenue bonds to originate federally guaranteed student loans in New Mexico. NMSL receives no state support; its expenses are paid from revenue earned from the loan program.

Mr. Nemelka provided an overview of the federal student loan program, which is funded by the United States Treasury and disbursed by schools to students who are enrolled at least half-time, who are making satisfactory academic progress and who are subject to annual borrowing limits. The origination fee is four percent, and interest rates vary between classifications of students, including undergraduate, graduate direct and graduate/parent; interest rates for all classifications are reset on July 1 every year. Mr. Nemelka noted that federal loan volumes in New Mexico have been decreasing substantially since a high of \$386,333,676 was reached in 2011-2012. In 2014, to date, the federal loan volume is approximately \$359 million. Federal education loans are used by both undergraduate and graduate students.

Mr. Nemelka then provided an overview of private education loans, which are made by states, nonprofits, banks and credit unions to borrowers attending certified schools. Although eligibility criteria for private education loans do not include an academic component, there may be incentives for criteria such as school program completion and on-time payments. Instead, eligibility is based solely on financial criteria such as borrower credit score, debt-to-income ratio and income level. There are rarely origination fees, and interest rates in New Mexico may range from 2.25 percent to 11 percent. In New Mexico, the volume of private education loans is low, estimated at \$5 million to \$8 million annually. Private education loans are used primarily by graduate students, out-of-state students paying nonresident tuition, programs with costs and fees exceeding federal borrowing limits and students seeking low interest rates.

Mr. Nemelka stated that he believes there is no educational loan funding crisis in New Mexico. He said that instituting a state-supported loan program in New Mexico could reduce the cost of financing a college education by offering lower interest rates and low or no origination fees and could expand access to low-interest loans by requiring less stringent credit criteria and providing local administration to reduce risk and losses. It would also retain loan earnings in New Mexico.

Mr. Nemelka described three national models of state-supported education loan programs that vary in cost, risk and complexity.

The first model, used by Texas, funds loans with state-issued general obligation bonds. In this model, the state holds and services the loans, combines academic and financial eligibility criteria, offers fixed interest rates of one percent to five percent and low or no origination fees and frequently requires cosigners. Mr. Nemelka said this is the highest cost and most complex program, with the greatest risk to the state. No other states use the Texas model.

The second model is the state guarantee/risk share model. Under this model, the state appropriates money to create a loss reserve fund; private lenders make the loans based on academic and financial eligibility criteria and cosigners are frequently required. This program was implemented in New York and New Jersey, but both states have closed the programs. No other states are currently using this model.

The third model is the state-supported loan securitization model. Under this model, private lenders make loans and secure them through student loan revenue bonds, which the state has pledged a "moral obligation" to support. Loans are made based on academic and financial criteria and frequently require cosigners. According to Mr. Nemelka, this model offers low rates and costs to borrowers, lowest cost and risk to the state and the simplest implementation. Mr. Nemelka said it is the most common state model.

In response to questions from committee members, Mr. Nemelka briefly described a federal teacher loan forgiveness program and the William D. Fort Federal Direct Loan Program. Mia Candelaria, HED, also briefly described an existing state medical loan-for-service program.

A committee member asked whether adopting a plan like the third model would put New Mexico in the education lending business and involve the sale of bonds. The question remained unanswered because the meeting was adjourned unexpectedly due to evacuation of the building.

Adjournment

After receiving an announcement regarding an emergency evacuation of the State Capitol, the chair announced that any remaining presentations on the IPOC agenda would be rescheduled for a later date. The committee adjourned at approximately 12:25 p.m.